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Hedge Funds Turn to Bench-Building

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By **Jon Jacobs**

The parade of talent from Wall Street to hedge fund land is swelling at the middle of the food chain, even while the exodus of high-profile stars has slowed.

Recruiters see funds ramping up their hiring of analysts with two to five years' experience, who can dramatically increase their compensation by getting the chance to run portfolios and directly participate in profits.

Many fund companies also are staffing up in non-investment areas like client service, marketing and operations, upgrading their capabilities after years of rapid growth.

"As more assets flow to the alternative world, the alternative world is having to beef up at all levels," says Tom Kellerhals, senior partner at the Westminster Group, a recruiting firm serving the asset management industry.

Fewer New Funds

The latest trend marks a consolidation of the myriad hedge funds formed in 2005 and 2006. Those years saw some of Wall Street's top bankers and traders defect from the banking world, often to launch their own operations.

Far fewer new funds and fund companies are starting up this year, says Sandy Gross, managing partner of Pinetum Partners LLC, a retained search firm serving both hedge funds and investment banks. However, funds that came into being during the past couple of years are actively hiring people with a few years' experience in an investment bank or asset management firm.

The typical new hedge fund company is a lean shop whose founders and principals personally run the portfolios. Once a fund has emerged from the start-up and capital-raising phase and become profitable, it needs support staff, Gross says. That's when managers start thinking about adding one or more analysts to assist with idea generation, analytical work, due diligence, and freeing up the boss to get out and prospect for business. There's even a danger that performance will suffer if a fund is too thinly staffed to properly handle the capital it's taking in.

Also, Gross says a fund may reach a point where it's more effective to bring in house functions it had outsourced during its start up, such as compliance, HR, IT or risk management.

Gross recently placed an analyst with four years of experience in a $400 million hedge fund firm. There he'll be a junior portfolio manager helping the firm make its first push into equities. Another client had a portfolio manager opening that will probably be filled by a senior buy-side analyst.

Switching From the Sell Side

Although the ideal candidates for such roles are people already working in hedge funds, in many cases the doors are open to analysts from long-only investment managers, or even with sell-side backgrounds.

Gross offers this caveat about the sell-side: A prospective switcher's tenure there should be brief. She says analysts who've spent more than a couple of years on the sell-side tend to become more focused on marketing and Institutional Investor rankings than on in-depth research. Also, sell-side analysts should be prepared to demonstrate they possesses "a feeling for managing a portfolio," Gross says.

For analysts from traditional buy-side firms, Gross cites two important criteria: understanding how to choose and manage short positions, and having concretely influenced a portfolio's composition and returns.

The Westminster Group's Kellerhals mentions two further factors: deep knowledge of a particular market segment, such as technology, and holding both an MBA degree and a CFA charter.

He also offers some insight into another focus of recent hedge fund hiring: client service personnel.

As a by-product of success, hedge funds are serving an increasingly institutionalized clientele. Institutional investors require far more service than the funds' traditional core market of wealthy individuals. "Even the pickiest high-net-worth client is not nearly as demanding as a large institution," observes Kellerhals.

Serving institutions means working with asset management consultants, providing detailed performance reports that comply with industry standards, answering request-for-proposals, and documenting how risks are managed. So, Kellerhals sees hedge funds increasingly hiring specialists in risk management, client service and proposal writing.

A Renewed Brain Drain?

Although sources say the hedge-fund-spurred, high-level brain drain from Wall Street peaked a year or so ago, the latest headlines indicate it may be picking up again.

The highest-ranking defector thus far in 2007 is Merrill Lynch's Dow Kim. In May, he stepped down as co-president of global markets and investment banking with plans to launch his own hedge fund firm. Earning $37 million last year, Kim was one of Merrill's highest-paid executives.

Earlier this week, Morgan Stanley's chief U.S. investment strategist left to join Fortress Investment Group. Henry McVey will lead a value equity investment team at Fortress, one of the largest hedge fund and private equity firms. He spent 12 years with Morgan Stanley, including three and a half years in his most recent role.